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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-705

HOUSEHOLD FINANCE CORPORATION,
HFC AMERICAN, INC., and
AMERICAN INVESTMENT COMPANY,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit.

OPINIONS BELOW

The opinions of the Court of Appeals (App. B, pp. 1b-19b) and of the District Court (App. A, pp. 1a-15a) are not yet officially reported.

JURISDICTION

The decision of the Court of Appeals was rendered on August 10, 1979. A timely petition for rehearing was denied on September 13, 1979 (App. C, p. 1c). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Whether, under Section 7 of the Clayton Act, complete overlap in the identity of customers is required in order to determine that two competing firms are within the same line of commerce.

2. Whether the court of appeals, in reviewing a decision of the district court pursuant to the recent amendments to the Expediting Act made by the Antitrust Procedures and Penalties Act of 1974, may set aside a judgment on the basis of a *de novo* review of the record *in camera* without regard to the trial court's findings of fact, which are supported by substantial evidence in accordance with Rule 52, Federal Rules of Civil Procedure.

STATUTE INVOLVED

Section 7 of the Clayton Act, 38 Stat. 731, as amended, 64 Stat. 1125, 15 U.S.C. § 18, provides in pertinent part:

> No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly.
>
> * * *

STATEMENT OF THE CASE

This action was initiated on January 9, 1979 by the filing of a complaint wherein plaintiff contended that the acquisition of the stock of American Investment Company ("AIC") by Household Finance Corporation ("HFC") violated Section 7 of the Clayton Act (15 U.S.C. § 18). The complaint alleged that actual competition in the making of direct cash loans by finance companies in various cities

within the United States might be substantially lessened by the acquisition. Subject matter jurisdiction of the district court was invoked under 15 U.S.C. § 25.

Pursuant to stipulation by the parties, the only issue tried was "whether the business of making direct cash loans by finance companies is a line of commerce within the meaning of Section 7 of the Clayton Act...." After a trial on the merits, the district court held that there was no violation of Section 7. On appeal, the Court of Appeals for the Seventh Circuit reversed.

I. The Consumer Credit Market

The consumer credit market has undergone a substantial transformation during the past twenty years and especially since the late 1960's. During this period, consumer installment credit has increased tenfold and is presently approaching $300 billion in outstandings.

Even more significant than the absolute growth in the consumer credit market is the change in market shares held by various types of institutions serving that market. The consumer credit market is served by commercial banks, finance companies, credit unions, thrift institutions and retailers. In the late 1950's and early 1960's, it may have been true that finance companies and retailers served a segment of the consumer loan market which commercial banks, credit unions and thrift institutions did not serve. However, with the rapid growth in the consumer credit market and the increasing attractiveness of that market, significant changes have taken place. Table I shows the change in the shares of the consumer installment credit market held by various participants in that market during the past decade.

TABLE I

CONSUMER INSTALLMENT CREDIT BY HOLDER
(in millions of dollars)

	1967	%	Oct. 1978	%
Commercial Banks	$33,152	41.7%	$132,457	49.9%
Finance Companies	24,576	30.9%	51,984	19.6%
Credit Unions	9,003	11.3%	44,635	16.8%
Retailers	11,484	14.5%	22,464	8.5%
Others*	1,213	1.5%	14,036	5.2%
	$79,428		$265,576	

* Includes Savings and Loan Associations and Mutual Savings Banks.

Table II converts the same data into 1967 dollars.

TABLE II

CONSUMER INSTALLMENT CREDIT IN 1967 DOLLARS BY HOLDER
(in millions of dollars)

	1967	Oct. 1978	% Change 1967-Oct. 1978
Commercial Banks	$33,152	$ 66,229	+ 99.8%
Finance Companies	24,576	25,992	+ 5.8%
Credit Unions	9,003	22,318	+147.9%
Retailers	11,484	11,232	− 2.9%
Others*	1,213	7,018	+478.6%
TOTAL	$79,428	$132,788	+ 67.2%

* Includes Savings and Loan Associations and Mutual Savings Banks.

Since 1967 the share of the consumer credit market held by finance companies increased in real dollars by only 5.8%. On the other hand, the share of the market in real dollars held by commercial banks increased by 99.8%, that

of credit unions increased by 147.9% and that of the "other" category, which includes savings and loan associations and mutual savings banks, increased by 478.6%.

The decrease in the market share of finance companies has been due directly to the increased competition from commercial banks, credit unions and thrift institutions. The primary reason for such significant changes in the consumer credit market is that commercial banks, credit unions and thrift institutions have embarked on aggressive programs of market penetration. These institutions have succeeded in competing in and have captured a significant portion of the consumer credit market previously served by finance companies. They have accomplished this by hiring former finance company personnel as loan officers and using methods previously identified solely with finance companies, such as consumer credit advertising and active solicitation of consumer credit customers.

The most innovative vehicle introduced into the consumer credit market during the past decade has been revolving credit, particularly bank credit cards. Table III compares bank revolving credit in gross dollars with personal loans made by commercial banks and finance companies in 1970 and 1978.

TABLE III

COMPARISON OF BANK REVOLVING CREDIT WITH PERSONAL LOANS (excluding automobile, mobile homes and home improvement financing) BY COMMERCIAL BANKS AND FINANCE COMPANIES
(In Millions of Dollars)

	Jan. 1970	Oct. 1979
Commercial Bank ..... Unsecured Credit	$14,766	$40,966
Finance Companies ..... Unsecured Credit	18,148	29,820
Bank Revolving ..... Unsecured Credit	3,907	22,165

Table IV presents the same data in 1967 dollars.

TABLE IV

COMPARISON OF BANK REVOLVING CREDIT WITH PERSONAL LOANS IN 1967 DOLLARS (excluding automobile, mobile home and home improvement financing) BY COMMERCIAL BANKS AND FINANCE COMPANIES
(In Millions of Dollars)

	Jan. 1970	1978	% Change Jan. 1970-Oct. 1978
Commercial Bank Unsecured Credit	$12,994	$20,483	+ 57.6%
Finance Companies ..... Unsecured Credit	15,970	14,910	− 6.6%
Bank Revolving ... Unsecured Credit	3,438	11,083	+222.4%

While personal loans made by commercial banks increased by 57.6% in real dollars from 1970 to 1978, the total outstandings in bank revolving credit increased by

222.4% in real dollars. In contrast, finance companies' personal loans during this period actually decreased in real dollars by 6.6%.

II. Proceedings Below

The complaint was filed on January 9, 1979. The trial was held from February 5, 1979 through February 26, 1979. The district court issued its opinion, dismissing the complaint, on March 23, 1979.

In the district court, plaintiff argued that direct cash loans made by finance companies to consumers constitute a unique product market on the grounds that finance companies are the only type of financial institution that deals primarily in the granting of such loans, that the characteristics of direct cash loans granted by finance companies are different from those granted by other types of financial institutions and that finance companies serve a significant number of higher risk customers who are not served by other types of financial institutions.

The district court rejected plaintiff's contentions. The district court acknowledged that the position taken by the government was "a correct statement and description of conditions existing in the consumer finance industry in 1960." (App. A, p. 3a). However, the district court recognized that the marked changes that have taken place in the consumer credit industry during the past twenty years compel the reassessment of the view that finance companies serve a distinct submarket. The court analyzed the market in general and concluded that the significant decrease in finance companies' share of the market was a direct result of aggressive competition from other types of financial institutions, particularly commercial banks.

In reaching its conclusion, the district court took particular notice of the tremendous market impact of commercial banks' revolving credit. From 1970 through 1978, bank revolving credit increased by over 222% and now totals

over $22 billion, in comparison to the $29.8 billion in outstanding personal loans held by finance companies. The court also noted that credit unions had expanded their portion of the market significantly and that over one-half of the adult population of the United States is now eligible to be a member of a credit union.

The district court also analyzed the types and characteristics of loans issued by various types of financial institutions and concluded that there were no significant differences in any of these factors with regard to the competing types of financial institutions.

Finally, the district court addressed the government's contention that the consumer credit market was segmented on the basis of risk and that finance companies serve higher risk customers who are not served by other financial institutions. The court analyzed studies of various credit scoring systems of competing institutions, studies of the credit outstandings of various finance company customers and statistical studies that attempted to determine whether the consumer credit market was, in fact, segmented on the basis of risk. The court concluded that "there is no significant market segmentation on the basis of risk with regard to the making of loans by various types of financial institutions." (App. A, p. 11a).

On appeal, the Court of Appeals for the Seventh Circuit reversed. The court of appeals did not dispute any of the district court's findings with regard to the structure of the consumer credit market and the changes that have taken place in that market nor did the court dispute the findings with regard to the relative fungibility of the credit packages offered by the various types of financial institutions. Rather, the court of appeals based its reversal on the fact "that the district court erred *as a matter of law* in concluding that no significant market segmentation exists." (App. B, p. 10b) (emphasis added) The court of appeals concluded "that the record below supports the proposition that finance

companies offer unique products and services to a class of higher-risk customers than are served by other financial institutions." (App. B, p. 19b) The court of appeals found from its *de novo* analysis of the record that such high risk customers constitute anywhere from 15% to 50% of finance company clientele. The court went further and stated that "even if these customers constituted a far lesser percent of the finance company clientele, we would still find that group significant." (App. B, p. 19b)

REASONS FOR GRANTING THE WRIT

I.

The Holding of the Court of Appeals That Complete Overlap in the Identity of Customers Is Required in Order To Determine That Two Competing Firms Are Within the Same Line of Commerce Is One of First Impression With Far-Reaching Implications for Basic Antitrust Analysis and Is in Conflict With Previous Holdings of This Court

A major goal of the antitrust laws is to nurture, protect and regulate competition and competitive behavior. The aim is to protect competition, not competitors. *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977); *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 320 (1962). In interpreting Section 7, this Court has set down various criteria for evaluating the competitive effects of any acquisition. These include standards for delineating a line of commerce and the requirement that competition be recognized where, in fact, competition exists. The holding of the Court of Appeals for the Seventh Circuit sets forth a unique rule of law to the effect that a relevant product market within the meaning of Section 7 can be defined solely on the basis of a distinct customer submarket. The Court of Appeals went further and held that the absence of 100 percent competitive overlap between two firms precludes a finding that the firms operate in the same line of commerce within the meaning of Section 7. Such a holding ignores

not only the economic realities of any industry, but rejects the standards enunciated by this Court for the delineation of a line of commerce.

A. The Holding of the Court of Appeals Ignored the Basic Tests Set Forth by This Court for the Delineation of a Relevant Submarket.

The basic test for determining the relevant product market in antitrust analysis was put forth in *United States* v. *E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 395 (1956):

> In considering what is the relevant market for determining the control of price and competition, no more definite rule can be declared than that commodities reasonably interchangeable by consumers for the same purposes make up that "part of the trade or commerce."

The *duPont* "reasonably interchangeable" test was expanded upon in *Brown Shoe Co.* v. *United States*, 370 U.S. 294 (1962), wherein this Court listed various "indicia" that should be used to delineate a proper market or submarket as a line of commerce. These include "industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." 370 U.S. at 325.

Several lower courts, including the Court of Appeals for the Seventh Circuit, have held that the most important of the *Brown Shoe* indicia is the "uniqueness of the product's functions and therefore its uses." *Sargent-Welch Scientific Co.* v. *Ventron Corp.*, 567 F.2d 701, 710 (7th Cir. 1977), *cert. denied*, 439 U.S. 822 (1978). The court of appeals in this case only paid lipservice to applying the "unique product or service" standard in reexamining the record. (App. B, pp. 6b-7b) The court's opinion clearly shows that it basically ignored any analysis of the uniqueness of the product or

any of the other *Brown Shoe* indicia, preferring to focus solely on distinct customers. In so doing, the court of appeals has developed a novel mode of market analysis that is at complete variance with the previous holdings of this Court.

To reach its result the court of appeals had to ignore the *Brown Shoe* indicia because consumer credit is basically fungible and it makes little difference by whom it is granted. The district court found and the record below supports the proposition that there is little difference in the characteristics of the loans made by various types of institutions including the size and maturity of loans, the purposes for which they are extended and the delinquency rates and charge-off rates of the various types of institutions granting such loans.[1] There is some difference between the interest rates charged by finance companies and that charged by banks, but the difference in such rates has been declining and is virtually non-existent when one considers the rate charged by credit cards, which is approximately 17-18%.[2]

1. In 1977, the average size personal loan made by finance companies was $1,393 while the average size unsecured personal loan made by commercial banks and credit unions was $1,480 and $1,898, respectively.

The average maturity for finance company loans in 1977 was 42.9 months while the most common maturity for large banks was 36 months. 33.7 percent of credit union loans carried maturities longer than 36 months and an additional 41.3% had maturities of 25-36 months.

In 1977, the 60-day delinquency rate for finance company loans outstanding was 3.2%. In 1978, the average delinquency rate for personal loans at commercial banks was 3.2%. In 1977, 3.6% of the number and 2.2% of the amount of outstanding loans in federal credit unions were 60 days or more delinquent.

In 1977, the nationwide charge-off rate for finance companies ranged between 1.75% and 2.04%. In the same year, the average installment credit dollar losses for commercial banks for personal unsecured loans was 1.45% gross and .94% net. This last figure for commercial banks does not include the losses on bank credit card loans, which are expected to total 1.8 to 2.4%.

2. Furthermore, a banker testified at trial that a recent survey of installment loan customers showed that 70% were more interested in the monthly payment than the interest rate. It was shown at trial that finance companies often accommodate their customers by extending the period of a loan by a month or two in order to reduce the monthly

Ignoring the fungibility of consumer loans granted by different types of financial institutions and the other *Brown Shoe* indicia, the court of appeals focused solely on distinct customers. By reexamining the record, the court of appeals concluded that anywhere between 15 and 50 percent of finance company customers would not be served by competing types of financial institutions. The court went further and held that even if the percentage of such customers were much smaller than 15%, that would be sufficient for a delineation of a submarket within the meaning of Section 7. The record simply fails to support the proposition that any significant number of finance company customers (and certainly not any number approaching 50%) cannot obtain credit from other financial sources. (See Point III *infra*). Further, the court of appeals' analysis of the relevant market is the first of its kind and totally at variance with all precedent.

The court of appeals purported to address the "unique service standard" (App. B, pp. 8b-10b). However, in so doing, the court engaged in an olympian leap of logic that has no support in any decided case. Because the court of appeals believed that market segmentation exists, it held that unique products or services must also exist. Thus, if 15% to 50% of finance company customers are not served by banks, a unique product or service must exist. This type of logic makes a mockery of this Court's reasoned analyses of relevant markets since *du Pont* and *Brown Shoe*.

Since this Court enunciated in *Brown Shoe* the various indicia to be used to delineate a relevant submarket, no court has ever found such a submarket based solely on the identification of a certain percentage of distinct customers. And in the few cases where distinct customers were of

payments. An example was given of a 24 month loan of $1,000 with the assumption of two interest rates -- one at 8% and the other at 16%. The monthly payment for each such rate would be $45 and $47.50. However, if the lender charging 16% extended the maturity period to 26 months as opposed to 24, the difference in monthly payments would be approximately 50 cents.

significance, the distinct customers constituted virtually 100% of the customer market. *See, e.g., Reynolds Metals Co.* v. *FTC*, 309 F.2d 223, 228-29 (D.C. Cir. 1962) ("With insignificant exception, the sole purchasers of florist foil are the nation's 700 wholesale florist outlets ...."); *U.S.* v. *Pennzoil Co.*, 252 F. Supp. 962, 975 (W.D. Pa. 1965) ("The independent producers of Penn Grade crude can sell their crude only to the six Penn Grade crude refiners"); *see also Seeburg Corp.* v. *FTC*, 425 F.2d 124, 128-29 (6th Cir.), *cert. denied*, 400 U.S. 866 (1970). (The court rejected a submarket that could be delineated only on the basis of distinct customers.) There is simply no precedent for the court of appeals' holding.

The weakness of the court of appeals' submarket is best demonstrated by asking the question: who is in that submarket? Is it made up of low income or blue collar workers, as the court of appeals intimated, despite the fact that such individuals may be excellent credit risks? The evidence at trial established that banks serve three times as many blue collar workers and more than two times as many low income consumers than do finance companies. If the market is not to be delineated on the basis of income or profession, should it be identified by comparing debt outstanding to the income or assets of the borrower? If so, what should be the appropriate cut off points for such delineation? There is simply nothing in the court of appeals' opinion or in the record that could assist in anyway in identifying the consumers in the court of appeals submarket.[3] In this regard the court's submarket is mythical and arbitrary.

3. A study was introduced into evidence that compared the credit scoring systems of HFC and two commercial banks. That study showed that HFC accepted 40% of its recent applicants, whereas the two banks would have accepted 56% and 35% of the HFC applicants. The court of appeals misconstrued this study, assuming that the banks would have accepted 56% and 35% of *accepted* HFC applicants rather than of all applicants. The court assumed that 65% and 44% of accepted HFC

Relevant to this point is the analysis of the court in *U.S.* v. *Jos. Schlitz Brewing Co.*, 253 F.Supp. 129 (N.D. Cal.), *aff'd per curiam*, 385 U.S. 37 (1966), wherein the court rejected the delineation of submarkets on the basis of price differentials between premium and non-premium beer. The court held:

> The trial court has found that in California, beer prices range over a wide spectrum from $.79 to $1.44 a six-pack. There is no rational way of choosing a point along this price spectrum and saying that all beer which sells above that point constitutes a line of commerce, or even a sub-market, apart from all beer which sells below that point. 253 F.Supp. at 145.[4]

Similarly, there is no rational basis for choosing a point that sets apart high risk from low risk borrowers.

The delineation of a relevant market "cannot be measured by metes and bounds." *Times-Picayune Publishing Co.* v. *United States*, 345 U.S. 594, 611-12 (1953). The court of appeals' delineation of a submarket on the basis of its mythical high risk consumers is totally at variance with the economic realities of the consumer credit industry. Petitioners respectfully submit that the holding of the court of appeals deals more with "ephemeral possibilities," which the Clayton Act was not designed to address, as opposed to the recognition of competition where, in fact, competition exists. *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 323, 325 (1962).

applicants could not get loans from banks. Contrary to the court's mistaken conclusion, the study provides streng evidence that such a submarket does not exist.

4. In *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 325-26 (1962), this Court refused to delineate separate submarkets for medium price and low price shoes on the same theory.

B. The Court of Appeals' Delineation of the Relevant Market Ignored the Existence of Substantial Competition

In failing to recognize competition where it clearly exists, the court of appeals erred as a matter of law. The district court found and the record below supports the proposition that the truly low risk consumers are almost exclusively served by banks and that the truly high risk consumers are not really served by any type of financial institution.[5] It is the moderate risk customer that is served by both banks and finance companies. Similarly the record below clearly shows that both banks and finance companies design, market and price their consumer lending packages for the same type of customer – the moderate risk consumer. These are the customers for whom all types of institutions in the market compete.

Nevertheless, even if one were to accept the finding of the court of appeals that 15% to 50% of finance company customers are not served by banks, it must be recognized that finance companies and other types of financial institutions are engaged in direct substantial competition for 85% to 50% of all borrowers. The court of appeals simply ignored this competition, citing *United States* v. *Connecticut National Bank*, 418 U.S. 656 (1974); *United States* v. *Phillipsburg National Bank*, 399 U.S. 350 (1970); and *United States* v. *Philadelphia National Bank*, 374 U.S. 321 (1963), in support of its submarket definition. But the court of appeals delineation of a product market turns these decisions on their head.

In *Connecticut National Bank*, this Court held that the relevant product market in the merger of two commercial banks was that "cluster of products and services" offered solely by commercial banks. In reversing the district

5. There was evidence in the record that showed high risk consumers most frequently obtain credit, when they are able to do so, from retailers who not only charge a relatively high rate of interest, but are also able to obtain a higher profit by marking up the sale prices of the goods and services sold.

court, which had included savings banks within the market, this Court stated that "the District Court overestimated the degree of competitive overlap that in fact exists between savings banks and commercial banks." 418 U.S. at 663. In so ruling, the Court placed emphasis on the fact that commercial banks in Connecticut had $1.03 billion dollars outstanding in commercial loans compared to only $26 million dollars in savings banks. However, the Court also stated:

> We do not say, and *Phillipsburg National Bank, supra*, and *Philadelphia National Bank, supra*, do not say, that in a case involving a merger of commercial banks a court may never consider savings banks and commercial banks as operating in the same line of commerce, no matter how similar their services and economic behavior. At some stage in the development of savings banks it will be unrealistic to distinguish them from commercial banks for purposes of the Clayton Act. In Connecticut, that point may well be reached *when and if savings banks become significant participants in the marketing of bank services to commercial enterprises.* 418 U.S. at 666 (emphasis added).

Using the analysis of the court of appeals, if savings banks in Connecticut were authorized to and did in fact market commercial services and the record showed that savings and commercial banks shared 85% to 50% of the commercial customers in that market, savings banks would still have to be excluded from consideration when defining the line of commerce. The court of appeals would exclude savings banks despite the fact that they had become "significant participants" in the commercial market. Such an interpretation, as well as the holding in this case, is contrary to *Connecticut National Bank* and all other precedent of this Court. *Connecticut National Bank* cannot be read to mean that savings and commercial banks can never be considered to be in the same line of commerce even where

savings banks become participants in the marketing of bank services to commercial enterprises to the extent that both types of institutions share 85% to 50% of the commercial customers.

In *United States.* v. *Continental Can Co.*, 378 U.S. 441 (1964), this Court held that glass and metal containers constituted a single line of commerce even though there was not complete competitive overlap. The Court stated:

> There may be some end uses for which glass and metal do not and could not compete, but complete interindustry competitive overlap need not be shown. We would not be true to the purpose of the Clayton Act's line of commerce concept as a framework within which to measure the effect of mergers on competition were we to hold that the existence of noncompetitive segments within a proposed market area precludes its being treated as a line of commerce. 378 U.S. at 457.

Before a court can carve out a submarket, it must show that the proposed submarket is "economically significant" in terms of competition. *International Telephone & Telegraph Corp.* v. *General Telephone & Electronics Corp.*, 518 F.2d 913, 932 (9th Cir. 1975). The antitrust laws were "not intended to reach every remote lessening of competition...." *Standard Fashion Co.* v. *Magrane-Houston Co.*, 258 U.S. 346, 357 (1922). Unfortunately the court of appeals ignored these teachings.

In analyzing the effects of the merger, the court of appeals simply failed to analyze or to give any credence to the effect of the active competition between finance companies and other types of financial institutions. Rather, the court focused on one economically insignificant class of customers, indistinguishable by concrete criteria, that it theorized are uniquely served by finance companies and concluded that the merger violated Section 7. Such conclusion ignores the realities of the market. Indeed that court focused on competition where it does not exist.

In *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 361 (1963), this Court was faced with the similar question of drawing a relevant market (in that case, a geographic market) so as to take into effect the varying financial resources of customers of banks. In that case, this Court stated:

> But that in banking the relevant geographical market is a function of each separate customer's economic scale means simply that a workable compromise must be found: some fair intermediate delineation which avoids the indefenseable extremes of drawing the market either so expansively as to make the effect of the merger on competition seem insignificant, because only the very largest bank customers are taken into account in defining the market, or so narrowly as to place appellees in different markets, because only the smallest customers are considered.

In drawing the appropriate product market in this case, the court of appeals ignored the economic realities of that market and, instead, preferred to draw a market based totally on a class of customers at the extreme end of the economic spectrum. In so doing, it has ignored the substantial competition existing among the participants in that market, which is reflected by the fact that the finance company share of the consumer credit market in constant dollars has increased over the past decade by only 5.8% whereas that of commercial banks has increased by 99.8% and that of credit unions by 147.9%. Such fundamental changes in the market place simply cannot be dismissed as irrelevant. *United States* v. *General Dynamics Corp.*, 415 U.S. 486, 501 (1974).

II.

The Decision of the Court of Appeals With Regard to the Relevant Product Market in the Consumer Credit Industry Is in Conflict with Well Established Supreme Court Decisions and Rulings of Other Courts and Federal Agencies.

The court of appeals has held that the competition between finance companies and commercial banks in the granting of consumer credit is not sufficiently significant to hold that finance companies and commercial banks actually compete in the same market. This holding is in conflict with the repeated rulings of the Federal Reserve Board, which is charged with evaluating the competitive effects of acquisitions by bank holding companies and other types of financial institutions. Since 1973, the Federal Reserve Board has held that the relevant product market to consider in the acquisition of a finance company by a bank holding company is the making of consumer cash loans and commercial banks are in direct competition with finance companies in this market.[6]

The interest of the Federal Reserve Board in the consumer credit market during the past decade is the result of the significant expansion of the consumer lending activities of commercial banks in every aspect of that overall market. In addition to the phenomenal growth of the commercial bank share of that market due to credit cards, which was discussed *supra*, commercial banks have also expanded their share of the consumer credit market through the direct acquisition of finance company subsidiaries. As of year-end 1977, 34 of the 100 largest non-captive finance companies in the United States had become subsidiaries of commercial banks.

Dr. Gregory Boczar, an economist with the Federal Reserve System,[7] testified at trial that among the factors

6. HX-181 is a compilation of 37 Federal Reserve opinions issued since 1973 wherein the Board took this position.

7. Dr. Gregory Boczar was incorrectly identified by the court of appeals as a defense expert. Actually, Dr. Boczar is presently serving as

the Federal Reserve Board considered prior to its issuance of rulings with regard to the existence of competition between commercial banks and finance companies in the consumer credit market was whether there was market segmentation based on the risk characteristics of consumers. Boczar himself conducted a multi-variate analysis of the risk characteristics of finance company customers.[8] Boczar concluded that market risk segmentation did not appear to be an effective impediment to competition and that both commercial banks and finance companies were serving the intermediate and low risk segment of the consumer credit market with neither of these institutions actually serving the high risk segment of the market.

The Department of Justice, in evaluating the effects of an acquisition between a commercial bank and a finance company, also has taken the position that finance companies and commerical banks compete in the granting of consumer credit. In a letter to the Federal Reserve Board, Assistant Attorney General Thomas E. Kauper has stated:

> Clearly the structure of the retail finance industries will be changed by such combinations and, as a consequence, long term competition between banks and finance companies will be reduced, while non-affiliated finance companies may have increased difficulty in attracting funds in times of credit shortage.
>
> Today, banks and finance companies compete in supplying retail credit needs for consumers; this is present in various forms of consumer loans and credit card transactions. In the long run, with the emerging electronic technology, banks and finance companies are likely to become competitors for consumer services on an even broader scale. (HX 223; *see also* HX 224; HX 225; HX 264; HX 299)

Project Manager, Division of Bank Supervision and Regulation, Federal Reserve Board, and has previously served as Special Assistant to Federal Reserve Governor Henry C. Wallich, and has worked extensively in the area of bank structure competition. Dr. Boczar testified before the district court pursuant to a subpoena issued by the court and received only statutory witness fees.

8. Boczar's study entitled "Competition between Banks and Finance Companies: A Cross Section Study of Personal Loan Debtors" was published in the *Journal of Finance* in March, 1978 and introduced as HX-200.

The Federal Reserve Board's finding that commercial banks are in direct competition with finance companies in the making of consumer cash loans was made in the context of evaluating acquisitions of finance companies by bank holding companies. However, the finding by the governmental agency responsible for the evaluation of the competitive effects of mergers among various types of financial institutions and its view of the competitive environment must be respected. The considered judgment of the Federal Reserve Board has evolved over the years. In 1973 the Board ruled that finance companies do compete with commercial banks in the market of "(1) personal loans of $1,400 or less, and (2) all direct consumer installment loans, the latter including personal loans and automobile, mobile home, and home improvement loans", *Bankers Trust New York Corporation*, 59 Federal Reserve Bulletin 694, 695 (1973), and the Board has repeatedly taken that position. *See e.g., F & M National Corporation*, 65 Federal Reserve Bulletin 165, 166 (1979).

As noted above, the court of appeals decision is one of first impression. However, the decision does reject the analysis and legal reasoning of many decisions of the other courts of appeals as well as of this Court. Moreover, in view of the fact that the Federal Reserve Board's rulings on the same issue presented by this case are directly opposite the holding of the Court of Appeals for the Seventh Circuit, petitioners respectfully submit that the issue is ripe for consideration by this Court.

III.

In Holding That the Consumer Credit Market Is Segmented on the Basis of Risk, the Court of Appeals Misconstrued and in Many Instances Misread Portions of the Record Upon Which It Based Its Decision and Accordingly the Decision of the Court of Appeals Is Erroneous

Petitioners recognize that it is not the function of an appellate court to reverse findings of fact of the lower court unless they are clearly erroneous within the meaning of Rule 52(a), Fed. R. Civ. P. However, this is the first case to reach this Court wherein a court of appeals reversed a district court's findings in a government Section 7 merger since the Expediting Act (15 U.S.C. § 29) was amended so as to permit court of appeals review of such cases. This Court has not heard a merger case on the merits since these amendments. In the past five years, the courts of appeals have assumed a central role in Section 7 enforcement and, in certain instances, the decisions of these courts have been contradictory both as to the ultimate judgments rendered as well as the methods of analysis employed. Such holdings have resulted in a widespread inability to predict the legality of a proposed merger at a time during which merger activity has increased dramatically.

The purpose of the 1974 amendments was to provide "for real appellate review," H.R. Rep. No. 93-1463, 93d Cong., 2d Sess. 8 (1974). Petitioners respectfully submit that this case is still in need of "real" appellate review because the court of appeals, in its review of the record, not only misconstrued, but actually misread the bulk of the evidence upon which it based its reversal of the district court and ignored substantial evidence that amply supported the district court's dismissal of the complaint. Petitioners also submit that the instant case presents a ripe opportunity for this Court to provide necessary guidance not only to the courts of appeals but also to the antitrust bar in general.

At the trial before the district court, HFC called 21 witnesses and introduced 28 affidavits and literally thousands of pages of exhibits. Plaintiff called 12 witnesses and introduced 9 affidavits and even more voluminous exhibits than those introduced by HFC. The evidence was introduced over 13 trial days. The district court issued its opinion, which included among its findings of fact:

> Although it may have been true in the past, statistics today demonstrate that there is no significant market segmentation on the basis of risk with regard to the making of loans by various types of financial institutions. Studies of the credit scoring systems of the various competing institutions reveal a broad and significant overlap in the credit scoring systems used by various competing institutions. Finance companies, banks, and credit unions all use substantially the same criteria in making credit decisions, and finance companies in the main do not have a higher or lower credit standard than other types of financial institutions. Neither do finance companies lend to any significant percentage of their customers who would be ineligible to borrow from other types of institutions. An analysis of the several studies available in the field reveals that significant percentages of finance company borrowers are eligible for or actually have nonmortgage loans, that the majority of customers of consumer finance companies have bank credit cards. (App. A, pp. 11a-12a)

The court of appeals initially proceeded to examine *de novo* some of the evidence relied upon by the district court for its findings of fact with regard to market segmentation and attempted to discredit all of that evidence. The court of appeals then itemized certain pieces of evidence that purportedly show significant market segmentation. In each instance, the court of appeals arrived at a somewhat perverted interpretation of the evidence and in many instances miscontrued it. The following paragraphs

briefly summarize the lack of foundation for the interpretation of the evidence relied on by the court of appeals.

According to the court of appeals, the district court relied upon the following sources of evidence to support its conclusion that market segmentation is not significant: two multivariate analyses of risk characteristics of finance company customers; credit scoring systems of various types of financial institutions; opinion testimony by bankers and finance company officers; and studies that showed finance company customers with various other types of bank credit.

First, the court of appeals totally misconstrued the purpose and results of two multi-variate analyses of the risk characteristics of bank and finance company customers. Both authors of the studies, Dr. Gregory Boczar and Dr. Neil Murphy testified at trial. Each explained that the purpose of his study was to examine a hypothesis that certain consumers with high risk characteristics could only borrow from finance companies and would not be considered good credit risks for commercial banks. The hypothesis would be tested by identifying from a data base those individuals with high risk profiles according to various risk related characteristics commonly used in credit scoring systems and then checking to determine if they were, in fact, finance company customers. Each author concluded that there was no significant market segmentation based on the risk characteristics of borrowers because their models were unable to delineate finance company borrowers. Thus, Dr. Boczar found that when he identified the high risk borrowers and then checked to see whether they were finance company customers, he was wrong two out of three times.

The court of appeals misconstrued Dr. Boczar's results and concluded that the study "necessarily entails the related conclusion that one-third of those customers have characteristics which would suggest that they would probably not be bank customers." (App. B, p. 11b). This is exactly the conclusion that the Government argued before

the district court and that was refuted by the district court and the record. Both of the multi-variate analyses started with the premise that if the market were actually segmented on the basis of risk, it would be relatively easy to determine finance company customers because they would have a high risk credit scoring profile. In the case of Dr. Boczar's study, the model was wrong two out of three times. Dr. Boczar explained that his study did not show that two out of three customers would necessarily get loans from banks nor that one out of three could not. It merely showed that using risk as a measure of analysis failed to support the proposition that the market was segmented.[9]

Second, the court of appeals also misconstrued a study that compared the credit scoring systems of HFC, Security Pacific Bank and the VISA Division of the First National Bank of Chicago. (App. B, pp. 13b-14b) That study showed that HFC accepted 40% of its recent applicants for consumer loans whereas, using their own credit scoring systems, Security Pacific Bank would have accepted 56% of the same applicants and given each a $1,000 line of credit while the First National Bank of Chicago would have accepted 35% of the same applicants and given each a

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9. In response to a government question, Dr. Boczar testified: "Now you can't have it both ways. Now if you are going to make me say that, in point of fact I don't know whether two out of three of them could get loans from banks. Then there is no way you could make me say that the other one-third couldn't get a loan at a bank." (Trial Tr. 1212)

Similarly, Murphy concluded as follows: "However, the multivariate analysis of the successful and unsuccessful borrowers in this study supports Benston's work. That is, in terms of the characteristics that were available and which are typically used in credit scoring models, there does not seem to be a systematic relationship between denials and the measures reflecting credit worthiness. Finally, when the group of successful applicants is disaggregated by the type of institution making the loan, there is little evidence to support the hypothesis of market risk segmentation. ***It is still not possible to predict which loans would be made, let alone by which institution***.... This inability to distinguish among the transactions made by the various institutions would indicate that, in Maine, banks, credit unions, and finance companies are real alternative suppliers and they compete in the same product market." (HX 204, p. 122) (emphasis added; citations omitted).

VISA card with a $1,000 or $2,000 line of credit. In interpreting this study, the court of appeals erroneously concluded that the 56% accepted by Security Pacific and the 35% accepted by the First National Bank of Chicago represented percentages of applicants HFC *had accepted*. Those figures actually represented the percentage of all of HFC's recent applicants – HFC itself only accepted 40% of these. The court's conclusion that "65% of those able to obtain loans at Household Finance apparently would be unable to obtain a VISA card from the First National Bank of Chicago, and slightly under one-half would have been able to obtain loans from Security Pacific" (App. B, pp. 13b-14b) is not only "clearly erroneous", but is blatantly incorrect.[10]

The court of appeals also curtly dismissed the significant effect that bank credit cards have had on the consumer credit market. There was evidence in the record that 50% of finance company customers have bank credit cards. The court of appeals, using a reverse-negative type of logic, concluded that the remaining 50% of finance company customers could not obtain such credit cards.[11] The court ignored the absence of any evidence in the record to support such a proposition. It also dismissed evidence to the effect that only approximately 35-50 percent of the population of the country as a whole have credit cards and that, in this regard, finance company customers simply reflect the population as a whole. The court ignored also the testimony of

10. Even more significantly, the HFC study showed that Security Pacific Bank would have accepted 49% of the applicants that HFC rejected and First National Bank of Chicago would have accepted 28% of such rejects.

James L. Smith, senior vice-president of Security Pacific, testified that in the first nine months of 1978, the Security Pacific credit scoring system approved approximately 154,000 applicants for personal loans. Of this number, only six were subsequently rejected for loans.

11. The repeated use of this reverse logic by the court of appeals only serves to accentuate the complete failure of plaintiff to bear its burden of proof.

a government witness who indicated that 80% of the customers of a finance company subsidiary of Citibank would have been eligible for a bank credit card issued by Citibank.

Similarly the court of appeals ignored the testimony of a large number of bankers and finance company officers who testified that banks and finance companies use the same credit standards. The vast majority of these witnesses testified that banks and finance companies apply the same credit standards and that there is no significant market segmentation on the basis of risk.

Finally, the court of appeals disputed the district court's findings that a significant number of finance company borrowers actually have credit outstanding from banks and credit unions. Deserving particular attention is the court of appeals' treatment of an HFC study of the last 50 loan applications of each of HFC's 426 offices throughout the country and which dealt with over 42,000 loan applications. The Court of Appeals misunderstood this study to be an analysis of only the last 426 loans issued by HFC (App. B, p. 15b). That study showed that of the 21,472 accepted loan applications, 31.94% had *existing balances* on auto loans from banks, 23.27% had *existing balances* on non-auto loans from banks and 31.94% had *existing balances* on bank credit cards. The court of appeals, again using a reverse-negative type of logic, assumed that all other HFC applicants were ineligible for bank credit and probably had never been eligible for such credit. All the study actually showed were those individuals who had existing balances on loans from banks. It did not show which applicants actually could have obtained additional credit from a commercial bank and it certainly did not show the percentage which could not obtain such credit. The court of appeals also ignored the fact that of the 20,663 applicants who were rejected by HFC, 26.21% had existing auto loans from

banks, 18.27% had existing non-auto loans from banks and 20.81% had existing balances on bank credit cards.[12]

After attempting to discredit the evidence relied upon by the district court, the court of appeals outlined the evidence that it relied upon for the finding that the consumer credit market is segmented on the basis of risk. The evidence was of three types: studies of eligibility of finance company customers for bank loans; varying chargeoff and delinquency rates between banks and finance companies; and studies of the demographics of borrowers at both institutions. Petitioners submit that such evidence provides no basis for the conclusion of market segmentation.

The court referred to certain "studies" dealing with the eligibility of finance company borrowers to obtain loans from banks. The first was a "study" performed by William Whitesell, a government witness. Whitesell testified that he evaluated the portfolio of a finance company that a bank wished to acquire and he concluded that 60% of the finance company customers would not have qualified for a loan from that bank. Whether Whitesell ever prepared a written version of this study is unclear, but no such study was ever introduced into the record. The Federal Reserve order (HX 256) approving the particular acquisition that Whitesell described shows that it involved the acquisition of a one-office finance company with loans outstanding of $1 million by a one-branch bank in rural Pennsylvania. Such a study based on a one-office finance company is hardly probative of the characteristics of finance company customers on a nationwide basis.

The second eligibility study relied upon by the court was performed by a vice-president of Citicorp, John Reed. Reed testified that only 46% of a sample of 175 customers of Nationwide Finance Company, a subsidiary of Citicorp, would be eligible for a loan from the bank. Reed also

12. Using the logic of the court of appeals, this particular study could be used to show that banks provide credit to certain high risk individuals who are unable to obtain credit from finance companies.

testified, however, that 80% of the customers of that finance company would have been eligible for a Citicorp credit card. The court of appeals completely ignored this latter portion of Reed's testimony.[13]

The third study relied upon by the court of appeals dealt with finance company borrowers in the State of Texas. Actually, the court confused two different studies dealing with Texas borrowers that were prepared by the same author, Dr. Thomas Durkin. (This accounts for the apparent contradictory references to these studies made by the court of appeals in its opinion. (App. B. p. 17b)). The first Durkin study dealt with what was known in Texas as the small, small loan act which regulates loans of $100 or less. That study, as the district court recognized, simply has no application to the issues in this case. The court of appeals also ignored the testimony of Dr. Durkin that the second study used 1973 data and that, based on his continuing research in the area, Dr. Durkin did not believe that there was any group of consumers to whom finance companies are the primary or sole source of credit.

The court of appeals also relied upon the differences it perceived in delinquency rates and chargeoff rates of banks and finance companies to support the proposition that finance companies offer a service unique to high risk customers. However, as described in Note 1, *supra*, there is actually no difference whatsoever in delinquency rates of finance companies and banks and the difference in chargeoff rates is relatively minor.

Finally, the court, relying on a study performed for HFC, found that finance companies serve a higher percentage of lower income and blue collar workers whereas banks serve a larger percentage of higher income and white collar

13. The court also overlooked Reed's testimony that Citibank has used and is continuing to use its finance company subsidiary and credit cards to expand its consumer loan operations nationwide. During the past year Citibank sent out 26 million letters soliciting credit card applications throughout the country.

workers.[14] One table of that study did in fact show that borrowers from banks had a higher average income than borrowers from finance companies and that a higher portion of finance company customers were blue collar workers rather than white collar workers. However, Table IB of that very same study showed that for borrowers in every income level (i.e., under $7,000, $7,000-$9,990, etc.) banks serve more than twice as many borrowers as finance companies. Thus, although finance companies serve 24.4% of debtors making less than $7,000 a year, commercial banks serve 56.3% of such debtors. Similarly, banks serve 55.1% of blue collar borrowers and finance companies only 18.2%. This study, as with the other evidence relied upon by the court of appeals, simply does not support the proposition for which it was cited nor does it support the overall conclusion of market segmentation.

14. The court of appeals obviously equated low income and a blue collar profession with high risk while ignoring the fact that individuals in such categories may constitute excellent credit risks whereas a high income, white collar worker may be on the verge of bankruptcy.

CONCLUSION

The court of appeals' decision should be reviewed because it sets forth a type of antitrust analysis that is totally at variance with judicial and regulatory precedent. Moreover, the court of appeals' holding will lead to further confusion concerning the correct indicia to be applied in defining a line of commerce under Section 7 of the Clayton Act. Finally, this case presents this Court with a unique opportunity to enunciate its basic antitrust principles as well as the principles for appellate review. The petition for a writ of certiorari should be granted.

Dated: November 1, 1979

Respectfully submitted,

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APPENDIX A

IN THE

United States District Court

FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 79 C 80

THE UNITED STATES OF AMERICA,

Plaintiff,

v.

HOUSEHOLD FINANCE CORPORATION,
HFC AMERICAN, INC., and
AMERICAN INVESTMENT COMPANY,

Defendants.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

On January 9, 1979, plaintiff, United States of America, filed a complaint seeking to prevent defendant Household Finance Corporation from acquiring the stock or assets of American Investment Company, for the reason that such acquisition would constitute a violation of §7 of the Clayton Act.

The plaintiff's prayer for relief was a request that the court enjoin the acquisition by Household Finance Corporation of American Investment Company, the acquisition of any stock in the American Investment Company by Household Finance Corporation directly or indirectly, and the divestiture of existing stock owned by Household Finance Corporation in American Investment Company. Finally,

the complaint sought an injunction against future acquisition by Household Finance Corporation of the assets of American Investment Company directly or indirectly without the approval of the Department of Justice or of the court.

On February 5, 1979, all the parties agreed to the following stipulation for the purpose of narrowing the issues to be tried in this case.

> 1. The only issue to be tried in this case is whether the business of making direct cash loans by finance companies is a line of commerce within the meaning of §7 of the Clayton Act.
>
> 2. If the court finds that the business of making direct cash loans by finance companies is a line of commerce in the United States generally, the acquisition of AIC by HFC would constitute a violation of §7 of the Clayton Act in various sections of the country and a permanent injunction against the acquisition of any stock in AIC by HFC directly or indirectly should be entered.
>
> 3. Such injunction should require divestiture of the existing stock ownership in AIC by HFC and prohibit the acquisition of any finance company assets of AIC by HFC directly or indirectly without the approval of the Department of Justice or of the court.
>
> 4. If the court finds that the business of making direct cash loans by finance companies does not constitute a line of commerce in the United States generally, the acquisition of AIC by HFC would not constitute a violation of §7, and an order of the court dismissing this action should be entered.

Accordingly, findings of fact and conclusions of law are proposed solely with regard to the relevant line of commerce in this case.

Findings of Fact

Historically, the consumer finance needs of the lower-income wage earner segment of the population have been served by the small loan industry. Until the early 1960's, it could truly be said that consumer finance companies engaged in the making of direct consumer loans and the servicing of retail sales finance contracts, were serving a lower-income and higher-risk consumer market than the commercial banks, savings and loan associations, and other lending institutions. It is apparent that the position adopted by the government (that the business of making direct cash loans by finance companies is a distinct line of commerce in the United States) is a correct statement and description of conditions existing in the consumer finance industry in 1960. It remains true that the major activity of consumer finance companies, including the defendants, is the making of cash loans to individual customers. Such loans are made, as they necessarily have been during all the relevant periods covered by the evidence in this litigation, under applicable laws of the various states which govern the interest rates charged, the size of such loans, the maturity periods, collateral required, and other terms of the loan contract.

But there have been significant changes in the character of the consumer finance industry, most particularly in the upward direction of the average amount of loans, and in the market expansion of that aspect of the business referred to during the trial as second mortgage lending, a service offered by the consumer finance companies involving larger average amounts loaned and loans collateralized by an interest in real estate.

In addition to these changes in the character of the consumer finance industry, an even more significant change has been the rapid growth since 1960 of competition in the consumer loan market from other financial institutions

heretofore not active in the consumer loan field. The three principal aspects of such increased competition are the aggressive entry into this market by the commercial banks, the real competition provided the small loan industry by the explosion in recent years in the numbers of bank credit card holders, the rapid growth of credit unions which compete with consumer finance companies directly, and the lesser, but not insignificant entry into this area of savings and loan associations.

So that while it is substantially true that the major business of the consumer finance industry continues to be cash loans to individual customers at high, but regulated, interest rates, and in generally small amounts, aggressive entry into competition with the consumer finance companies by the variety of other financial institutions above described, has created a very substantial overlap of a number of competitors seeking and serving the same consumer market as was once deemed to be the exclusive province of the consumer finance companies. This broad overlap and aggressive competition compels a reassessment of the once-distinct submarket served by the consumer finance companies, a submarket which can no longer be recognized as a distinct or identifiable line of commerce within the meaning of §7 of the Clayton Act.

In support of these general conclusions thus enunciated as the findings and conclusions of this court, the following, more particular, findings of fact are made.

1. During the past decade, the finance companies' share of the consumer installment credit market has decreased by one-third while the market shares of commercial banks and credit unions have increased dramatically.

2. The total outstandings of consumer installment credit by holder in 1967 and again, a decade later, in 1978 is illustrated by the following tables:

CONSUMER INSTALLMENT CREDIT BY HOLDER
(in millions of dollars)

	1967	Oct., 1978
Commercial Banks	$33,152	$132,457
Finance Companies	24,576	51,984
Credit Unions	9,003	44,635
Retailers	11,484	22,464
Others*	1,213	14,036
	$79,428	$265,576

* Includes savings and loan associations and mutual savings banks.

PERCENTAGE OF CONSUMER INSTALLMENT CREDIT HELD BY VARIOUS INSTITUTIONS

	1967	Oct., 1978
Commercial Banks	41.7%	49.9%
Finance Companies	30.9	19.6
Credit Unions	11.3	16.8
Retailers	14.5	8.5
Others	1.5	5.2

CONSUMER INSTALLMENT CREDIT IN 1967 DOLLARS BY HOLDER
(in millions of dollars)

	1967	Oct., 1978	% Change 1967-Oct., 1978
Commercial Banks	$33,152	$ 66,229	+ 99.8%
Finance Companies	24,576	25,992	+ 5.8%
Credit Unions	9,003	22,318	+147.9%
Retailers	11,484	11,232	− 2.9%
Others*	1,213	7,018	+478.6%
Total	$79,428	$132,788	+ 67.2%

* Includes savings and loan associations and mutual savings banks.

These tables reveal that the share of the consumer installment credit market held by finance companies has decreased by approximately one-third during the past decade, while the market shares of commercial banks and

credit unions have increased significantly. These tables show further that, during the past decade, the amount of consumer installment credit held by finance companies has increased in real dollars by only 5.8%, while that of commercial banks has increased by 99.8%, that of the credit unions by 147.9%, and the "other" category, which includes savings and loan associations and mutual savings banks, by 478.6%.

3. One aspect of the expanding and aggressive competition of the commercial banks with the consumer finance industry is revealed in a comparison of bank revolving credit (including credit cards) with personal loans made by commercial banks and finance companies (excluding automobile, mobile home, and home improvement financing) in 1970 and 1978.

COMPARISON OF BANK REVOLVING CREDIT WITH PERSONAL LOANS IN 1967 DOLLARS (EXCLUDING AUTOMOBILE, MOBILE HOME AND HOME IMPROVEMENT FINANCING) BY COMMERCIAL BANKS AND FINANCE COMPANIES

(in millions of dollars)

	Jan., 1970	1978	% Change Jan., 1970-Oct., 1978
Commercial Banks ..... Unsecured Credit	$12,994	$20,483	+ 57.6%
Finance Companies ..... Unsecured Credit	15,970	14,910	− 6.6%
Bank Revolving ..... Unsecured Credit	3,438	11,083	+222.4%

As the above table reveals, the personal loans made by commercial banks have increased by 57.6% in real dollars, the total outstandings in bank revolving credit have increased by 222.4% in real dollars, and, in contrast, finance companies' personal loans during this period have decreased in real dollars by 6.6%.

This decrease in the finance companies' share of the consumer credit market has been directly due to the increased competition from commercial banks, credit unions and thrift institutions.

4. Among the reasons for the increase in the commercial banks' and credit unions' share of the consumer credit market is the increasing awareness by consumers of the relative interest rates charged by various types of lending institutions as the result of the Truth-in-Lending Act and the disclosures required by that Act, as well as various actions by the Federal Reserve Board.

The 1977 Consumer Credit Survey, published by the Federal Reserve Board (GX 175), reveals that consumers at each educational level, within each age category, and within each income grouping have become increasingly aware of the actual cost of their credit. As other financial institutions have aggressively sought customers once thought to be the exclusive market of the consumer finance companies, they have had the significant competitive advantage of a growing consumer awareness of their lesser interest rates.

5. Among the means used by the commercial banks to expand their consumer credit lending operations at the expense of consumer finance companies has been the adoption by the commercial banks of finance company techniques, and the hiring away of former finance company personnel as an aid to competing with the consumer finance companies.

6. Another significant advantage enjoyed by the commercial banks and credit unions is the lower cost to them of funds, in comparison to the fund cost to the consumer finance companies. Consumer finance companies obtaining funds in the public market are at a disadvantage vis-a-vis depository institutions such as banks and credit unions.

7. The use of bank credit cards and other forms of revolving credit by commercial banks has had a major, nationwide impact on the consumer credit market in recent years, and has been the vehicle for permitting commercial banks to move aggressively into the consumer credit market and to attract consumers who formerly turned to consumer finance companies for their cash loan needs.

8. Bank credit cards are used by holders for two purposes. Their principal use is to facilitate retail purchases on credit, and the secondary use is as a source of cash credit. Applicants can obtain credit cards with a credit limit as low as $300 or as high as $10,000. The most prevalent lines of credit extended by the First National Bank of Chicago on its bank credit card average between $1,000 and $2,000 (Tr. 1374).

9. Credit card holders are enabled to utilize their credit cards to purchase items the acquisition of which would have required an installment cash loan before the advent of the widespread use of credit cards. The holders of bank credit cards may also obtain direct cash loans from the bank by using the cash advance feature of the credit card. The amount of cash thus available is limited only by the credit limit for the card. This cash is available to credit card holders at the prevalent 18 percent interest rate for outstanding balances on such cards. This use of the cash advance feature of a credit card is more convenient to obtain modest amounts of cash than a cash loan from a finance company.

10. In addition to credit card-related arrangements for direct cash loans, most commercial banks now also offer lines of credit connected to checking accounts maintained at a particular bank. Once a line of credit is approved, the consumer may overdraw his checking account by any

amount up to the maximum line of credit. The writing of such check constitutes a direct cash loan.

11. Both the cash available on demand by credit card holders and the overdraft features on checking accounts are substitutes for and competitive with the unsecured cash installment loans of the consumer finance company, which have been the traditional bulk of their business.

12. An additional, significant and growing factor in the consumer finance field is the impressive growth in the United States of credit unions. Credit unions have recently grown in membership by more than one million people per year, to the point where half of the adult population is now a member of or has access to a credit union (Tr. 1931).

13. Credit unions have financial advantages which other financial institutions do not enjoy. Federal credit unions are not taxed by the federal government and most state credit unions are not taxed by state governments. Corporations and labor unions have an incentive to set up credit unions for their employees and their members as an additional inducement to employment or membership. The credit union normally obtains direct access to members' paychecks through payroll deductions, and credit union inserts in payroll envelopes provide an easy and inexpensive advertising access to the potential membership.

14. Credit unions enjoy a competitive advantage over finance companies and even over bank credit cards because of their lower interest rates, a competitive advantage which, in recent years, they have aggressively exploited.

15. Credit unions in recent years have been authorized to issue revolving charge cards such as Visa and MasterCharge, and many are now offering share draft accounts

whereby a member is able to draw a check on these share accounts. They are also authorized to make first mortgages. All of these circumstances make them highly effective competitors with the consumer finance companies for the wage earner market.

16. To a lesser extent than the commercial banks, but still significantly, savings and loan associations have, in recent years, become competitors with consumer finance companies. Savings and loan associations have entered into the field of home improvement loans and home equipping loans; depositors and thrift institutions may also borrow against their passbook deposits, and thrift institutions now have the power to issue bank revolving credit cards such as Visa and MasterCharge in certain states, and are attempting to broaden this capability.

17. Home refinancing through second mortgages or refinancing of first mortgages has become an increasingly important part of the consumer credit market, and the proceeds of such mortgages are being used for a wide variety of consumer purposes. Consumer finance customers have become aware in rapidly growing numbers of the potential borrowing power created by the equity they have in their homes. Consumer finance companies, commercial banks, savings and loan associations, have all moved aggressively and competitively into this field.

18. The average size of personal, unsecured loans from the finance companies has tended in recent years to increase. The average size of commercial loans and loans from other competing institutions has tended to decrease as they reach aggressively into the lower-income borrowing market. Thus, the average size of the consumer finance company loan and those of the commercial banks tend to

approach each other (Tr. 2144), and this trend is apparently destined to continue. The same trend can be noted in the average maturities of the various types of loans.

19. The average delinquency rates of consumer finance companies are progressively declining and the average delinquency rates of personal loans of commercial banks have been increasing as these two types of institutions move into competition in one another's market area (Tr. 2176). Similar trends are manifest in the charge-off rates of the two types of lenders (Hett aff. p. 9).

20. As commercial banks and other institutions move into the consumer finance field in growing numbers, the interest rates charged by these institutions on this type of loan tend to increase (Tr. 1371). As consumer finance companies react to this new and intense competition from other financial institutions, the interest rates charged by consumer finance companies tend to decrease (Tr. 1297). The laws of many states have been changed to permit both banks and finance companies to make loans within the same range of interest rates.

21. Although it may have been true in the past, statistics today demonstrate that there is no significant market segmentation on the basis of risk with regard to the making of loans by various types of financial institutions. Studies of the credit scoring systems of the various competing institutions reveal a broad and significant overlap in the credit scoring systems used by the various competing institutions. Finance companies, banks, and credit unions all use substantially the same criteria in making credit decisions, and finance companies in the main do not have a higher or lower credit standard than other types of financial institutions. Neither do finance companies lend to any significant percentage of their customers who would be ineligible to borrow from other types of institutions. An analysis of

the several studies available in the field reveals that significant percentages of finance company borrowers are eligible for or actually have non-mortgage loans at banks, that the majority of customers of consumer finance companies have bank credit cards.

22. In addition, statistical studies reveal a substantial overlap between customers of finance companies and credit unions, thrift institutions, and retailers (Tr. 1004, GX 144, HX 210).

23. A significant indicia of the competition for the consumer loan market and the loss of market share by finance companies to commercial banks is found in the attempt of the small loan industry to recapture some of the customers taken away by the commercial banks adopting many of the same types of programs which have cost them their customers to the commercial banks. Several finance companies have begun to offer their own individual credit card. Some are offering Visa and MasterCharge cards. Finance companies are also making revolving lines of credit available through a check system whereby the amount of the check is debited against the consumer's account in the loan office. Finance companies also participate in retail revolving credit on a private label basis in the same manner as commercial banks.

24. The Federal Reserve Board, which is charged with evaluating the competitive effects of acquisitions by bank holding companies and other types of financial institutions, consistently has held that the relevant product market to consider in the acquisition of a finance company by a bank holding company is the making of personal cash loans, and that finance companies and commercial banks do compete in the making of such loans (HX 181).

25. The Antitrust Division of the Department of Justice has taken the position that finance companies and the commercial banks compete in the granting of consumer credit (HX 223, 224, 255, 264, 299). The Department of Justice has stated:

> Clearly, the structure of the retail finance industry will be changed by such combinations, and, as a consequence, long-term competition between banks and finance companies will be reduced, while non-affiliated finance companies may have increased difficulty in attracting funds in times of credit shortage.
>
> Today, banks and finance companies compete in supplying retail credit needs for consumers; this is present in various forms of consumer loans and credit card transactions. In the long run, with the emerging electronic technology, banks and finance companies are likely to become competitors for consumer services on an even broader scale.
>
> (Department of Justice letter re acquisition of GHC Finance by Bank America Corporation, 6/26/73. HX 123)

26. The Comptroller of the Currency also requires an analysis of finance company competition with regard to the merger of national banks or of a state bank into a national bank.

27. In summary, finance companies and commercial banks compete with one another in the granting of consumer credit. Finance companies and credit unions compete with one another in the granting of consumer credit. Finance companies and thrift institutions compete with one another in the making of consumer loans. And finance companies and large credit-oriented retailers compete with one another in the area of consumer credit.

Conclusions of Law

1. The relevant product market ("line of commerce") within the meaning of §7 of the Clayton Act is consumer installment credit. Finance companies face substantial direct competition from commercial banks, credit unions, thrift institutions, and retailers in offering consumer installment credit and no realistically distinct submarket can be said to exist.

2. The consumer installment credit market consists of the consumer loan activities of commercial banks, credit unions, thrift institutions, finance companies and retailers.

3. If the line of commerce were to be held to be the business of making direct cash loans, finance companies face substantial direct competition from commercial banks, credit unions, and thrift institutions in making direct cash loans and no realistically distinct submarket can be said to exist.

4. The market for the business of making direct cash loans consists of the consumer loan activities of commercial banks, credit unions, thrift institutions and finance companies.

5. The plaintiff has not established that the business of making direct cash loans by finance companies is a line of commerce within the meaning of §7 of the Clayton Act.

6. The merger in issue here cannot be said to have a probably anticompetitive effect or to threaten the substantial lessening of competition.

7. Therefore, the complaint is dismissed with prejudice and judgment entered for defendants.

ENTER:

/s/ FRANK J. McGARR

.....

UNITED STATES DISTRICT JUDGE

DATED: March 22, 1979

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 79 C 80

THE UNITED STATES OF AMERICA,

Plaintiff,

v

HOUSEHOLD FINANCE CORPORATION,
HFC AMERICAN, INC., and
AMERICAN INVESTMENT COMPANY,

Defendants.

JUDGMENT ORDER

Pursuant to Findings of Fact and Conclusions of Law entered this day, the complaint is dismissed with prejudice and judgment is entered for defendants.

ENTER:

/s/ FRANK J. McGARR

.....

UNITED STATES DISTRICT JUDGE

DATED: March 22, 1979

APPENDIX B

In the

United States Court of Appeals

FOR THE SEVENTH CIRCUIT

No. 79-1313

UNITED STATES OF AMERICA,
Plaintiff-Appellant,

v.

HOUSEHOLD FINANCE CORPORATION,
HFC AMERICAN, INC., and
AMERICAN INVESTMENT COMPANY,

Defendants-Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE
NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION.

NO. 79 C 80–FRANK J. MCGARR, JUDGE.

ARGUED MAY 31, 1979–DECIDED AUGUST 10, 1979

Before SWYGERT, *Circuit Judge,* GEWIN, *Senior Circuit Judge,** and SPRECHER, *Circuit Judge.*

SPRECHER, *Circuit Judge.* The issue raised by this appeal is whether the business of making direct cash loans by finance companies is a line of commerce within the meaning of section 7 of the Clayton Act, 15 U.S.C. § 18. More specifically, the issue is whether finance companies effectively compete with other financial institutions, e.g., banks, credit unions, and savings and loan associations, in

* Walter P. Gewin, Senior Circuit Judge of the United States Court of Appeals for the Fifth Circuit, is sitting by designation.

the extension of loans. The district court found that personal loans from finance companies do not constitute a separate line of commerce. We hold, however, that the district court in reaching this conclusion both incorrectly applied legal standards and made clearly erroneous findings of fact. Accordingly, we reverse.

I

On January 9, 1979, the United States filed a civil action against Household Finance Corporation (HFC), one of its subsidiaries, and American Investment Company (AIC). The complaint alleged that a proposed merger between HFC's subsidiary and American Investment Company would violate section 7 of the Clayton Act, 15 U.S.C. § 18. This violation was premised on the fact that the proposed acquisition would allegedly lessen substantially competition in the making of "direct cash loans" by finance companies in numerous sections of the country.

On February 5 the parties agreed to the following stipulation for the purpose of narrowing the issues to be tried.

> 1. The only issue to be tried in this case is whether the business of making direct cash loans by finance companies is a line of commerce within the meaning of § 7 of the Clayton Act.
>
> 2. If the court finds that the business of making direct cash loans by finance companies is a line of commerce in the United States generally, the acquisition of AIC by HFC would constitute a violation of § 7 of the Clayton Act in various sections of the country and a permanent injunction against the acquisition of any stock in AIC by HFC directly or indirectly should be entered.
>
> 3. Such injunction should require divestiture of the existing stock ownership in AIC by HFC and

> prohibit the acquisition of any finance company assets of AIC by HFC directly or indirectly without the approval of the Department of Justice or of the court.
>
> 4. If the court finds that the business of making direct cash loans by finance companies does not constitute a line of commerce in the United States generally, the acquisition of AIC by HFC would not constitute a violation of § 7, and an order of the court dismissing this action should be entered.

The issues having been thus narrowed, the district court conducted a 13-day trial. During this trial testimony was introduced from various government officials who regulate financial institutions, executives and managers of financial institutions, and professional economists. The district court then made its findings of fact and concluded that the making of direct cash loans by finance companies was not a separate line of commerce.

The district court opinion begins by conceding that at one time consumer finance companies served a distinct consumer population consisting of "a lower-income and higher-risk consumer market than [was served by] the commercial banks, savings and loan associations, and other lending institutions." However, the district court believed that recent expansions by other institutions in lending activity with respect to this lower-income, higher-risk group "has created a very substantial overlap of a number of competitors seeking and serving the same consumer market as was once deemed to be the exclusive province of the consumer finance companies."

Various facts were relied on by the district court in support of this conclusion. First, the court cited statistics demonstrating the increasing involvement of commercial banks, credit unions, and savings and loan associations in

the consumer installment market. Whereas the finance company market share, based on dollar amount of loans, decreased between 1967 to 1978 from 30.9 percent to 19.6 percent, the market share of banks increased from 41.7 percent to 49.9 percent and the market share of credit unions increased from 11.3 percent to 16.8 percent. The court also cited figures which, after adjustment for inflation, showed that real dollar amounts of bank credit during this period increased 99.8 percent; of finance company credit, 5.8 percent; and of credit union credit, 147.9 percent. The court sought to explain these alterations in market shares by finding that consumers were increasingly aware of interest rates, thereby giving a competitive advantage to lower-cost forms of credit.

Next, the court analyzed the competitive inroads made on consumer finance company business by credit cards and credit unions. Although the court made no findings as to how many customers of consumer finance companies could obtain, or had obtained, credit cards on which there were sufficient balances to meet the consumer's credit needs,[1] the court found that these cards have had a "major" impact on the credit market and have served as "the vehicle for permitting commercial banks to move aggressively into the consumer credit market . . . ." Further, the court found that obtaining cash advances through credit cards was more convenient than, and a substitute for, obtaining a cash loan from a finance company. As to credit unions, the court found that they have experienced "impressive" growth and have been effective competitors with finance companies because of their lower rates as well as their ability to utilize payroll deductions. The court further

1. The court did erroneously find, see pp. 9, 13-15, that a majority of the customers of consumer finance companies possessed bank credit cards. However, it did not find what portion of those cards had sufficient remaining balances.

found, however, that as much as 50 percent of the population had no access to credit unions.

The court then proceeded to find that, in terms of several general indicia, finance company loans and bank loans were becoming increasingly similar. The average amount of finance company loans was found to be increasing while the higher average amount of a bank loan was decreasing. Likewise, finance company delinquency and charge-off rates were declining while the lower bank rates were increasing. Interest rates were said to be converging as well. Further, the credit scoring systems used by banks and finance companies to determine loan eligibility overlap so that "finance companies in the main do not have higher or lower credit standard [sic] than other types of financial institutions." The court also found a "substantial overlap between customers of finance companies and credit unions, thrift institutions, and retailers."

Finally the district court relied on findings by government agencies that banks and finance companies compete. Both the Federal Reserve Board and the Justice Department have taken the position in evaluating bank-finance company mergers that banks and finance companies compete.

Based on these findings the district court concluded that the making of direct cash loans by finance companies was not a line of commerce within section 7 of the Clayton Act. Thus, under the terms of the stipulation, the proposed merger would not have an anticompetitive effect. Accordingly, the district court dismissed the complaint.

II

Although the district court did not explicitly set out the legal standard by which it should be determined whether the business engaged in by finance companies is a distinct line of commerce, it is clear what that standard should be.

The Supreme Court has repeatedly held that a financial institution comprises a separate product market if it offers to a "significant" number of consumers a "cluster of products and services" that competing financial institutions do not. *United States* v. *Connecticut National Bank*, 418 U.S. 656, 664 (1974); *United States* v. *Phillipsburg National Bank*, 399 U.S. 350, 360 (1970); *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 356-57 (1963). Thus, for example, *Connecticut National Bank* concluded that banks were a separate line of commerce because they could provide services to commercial customers more effectively than savings and loan associations. The factors supporting this conclusion were the overwhelming dominance of banks in the commercial loan market (1 billion dollars versus 26 million dollars) and the inability of savings and loan associations, even under pending legislation, to offer checking accounts to commercial customers. 418 U.S. at 664-66. Accordingly, if, as the government alleges, finance companies provide loans, counseling and other financial services to lower-income, higher-risk customers which other financial institutions do not, the standards set out by the Supreme Court would compel a finding that cash loans by finance companies constitute a line of commerce within the meaning of section 7.[2] Furthermore, *Phillipsburg National Bank* and *Connecticut National Bank* made it clear that the fact that banks and other financial institutions compete with finance companies in the provision of other services, such as the extension of loans to moderate or low risk consumers, is not relevant to the inquiry here. These other service areas

2. The availability of loans to high risk consumers has been explicity recognized by the Supreme Court as a unique service:

> For some customers, full-service banking makes possible access to certain products or services that would otherwise be unavailable to them; the customer without significant collateral, for example, who has patronized a particular bank . . . is more likely to be able to obtain a loan from that bank . . . .

Phillipsburg Nat'l Bank, 399 U.S. at 360.

may be relevant "in analyzing the effect on competition between a commercial bank and another type of financial institution," *Phillipsburg National Bank*, 399 U.S. at 360, but in determining the effect of competition in mergers of one type of institution, it is the effect in any area of unique services that must be considered.[3] *Phillipsburg National Bank*, 399 U.S. at 360-61; *Connecticut National Bank*, 418 U.S. at 663 n.3.

It should also be noted, as an introductory matter, that, although the Supreme Court may not have fully considered and finally concluded the matter, it has stated in two of the cases cited above that banks do not compete with finance companies in the extension of cash loans. Thus, in *Philadelphia National Bank* the Court declined to include banks and finance companies in the same market. The Court stated:

> Some commercial banking products or services are so distinctive that they are entirely free of effective competition from products or services of other financial institutions; the checking account is in this category. Others enjoy such cost advantages as to be insulated within a broad range from substitutes furnished by other institutions. For example, commercial banks compete with small-loan companies in the personal-loan market; but the small-loan companies' rates are invariably much higher than the banks', in part, it seems, because the companies'

3. Thus the Federal Reserve Board, the Comptroller of the Currency and the Justice Department have considered competition in these overlapping markets when analyzing the effects of mergers between different types of financial institutions, *e.g.*, between banks and financial institutions. (HX 181, 255, 264, 299). In such mergers it is obvious that the important inquiry revolves around concentration in jointly provided services, since any lessening of competition will occur, if at all, only in those areas. It is this confusion about which submarkets to consider which underlies most of the district court's position that finance companies are not a distinct line of commerce because at least with respect to many customers finance companies and other financial institutions in fact "compete."

> working capital consists in substantial part of bank loans.

374 U.S. at 356.[4] This passage was cited with approval in *Phillipsburg National Bank*, 399 U.S. at 361 n.4. The record before us substantiates that banks continue to offer loans at a lower cost than finance companies,[5] thus making currently applicable the Supreme Court's finding that personal loans made by banks are "insulated" from competition by finance companies and that the two thus constitute separate product markets.

Applying the "unique product or service" standard, an examination of the record before us further supports the conclusion that the extension of cash loans by a finance company constitutes an independent line of commerce. We note first that very few of the district court's findings affect this conclusion. Most of the district court findings merely indicated a trend for banks to increase their loan activity with respect to some customers who formerly had been serviced only by finance companies. As was made clear in *Connecticut National Bank*, a trend towards an overlap in services in and of itself is not sufficient to support a finding that sufficient overlap currently exists to preclude a finding

4. The Court further elaborated this position in a footnote:

> As one banker testified quite frankly in the instant case in response to the question: "Do you feel that you are in substantial competition with these institutions [personal-finance and sales-finance companies] that you lend . . . such money to for [sic] loans that you want to make?" - "Oh, no, we definitely do not. If we did, we would stop making the loans to them." (R. 298.) The reason for the competitive disadvantage of most lending institutions *vis-a-vis* banks is that only banks obtain the bulk of their working capital without having to pay interest or comparable charges thereon, by virture of their unique power to accept demand deposits.

374 U.S. at 356 n.33.

5. The National Commission on Consumer Finance found that the average interest rate charged by consumer finance companies was 26 percent, whereas 13 percent was the average rate for banks. (Tr. 625). No testimony was offered at trial to rebut these figures.

that one type of institution offers a "unique cluster of products and services."[6] Thus, although we do not dispute the district court's findings of increasing market shares of banks, savings and loan associations, and credit unions or of converging interest rates, write-off rates and loan amounts, we do not believe these findings to be legally sufficient to support a conclusion that finance companies are not engaged in a distinct line of commerce.

Only one finding was made by the district court that would satisfy the "unique service" standard. The district court stated:

> Although it may have been true in the past, statistics today demonstrate that there is no significant market segmentation on the basis of risk with regard to the making of loans by various types of financial institutions . . . . Finance companies, banks, and credit unions all use substantially the same criteria in making credit decisions, and finance companies in the main do not have a higher or lower credit standard than other types of financial institutions. Neither do finance companies lend to any significant percentage of their customers who would be ineligible to borrow from other types of institutions. An analysis of several studies available in the field reveals that significant percentages of finance company borrowers are eligible for or actually have non-mortgage loans at banks, that the majority of customers of consumer finance companies have bank credit cards.

6. As the Court stated in *Connecticut National Bank*:

> To be sure there is a large measure of similarity between the services marketed by the two categories of banks. In our view, however, the overlap is not sufficient at this stage in the development of savings banks . . . to treat them together with commercial banks . . . . Despite the strides that savings banks . . . have made toward parity with commercial banks, the latter continue to be able to provide a cluster of services that the former cannot . . . .

418 U.S. at 663-64.

We believe, however, that the district court erred as a matter of law in concluding that no significant market segmentation exists.[7]

The thrust of the district court's conclusion, thus, is that although concededly some customers are uniquely served by finance companies, the number of such customers is insignificant. Obviously evaluating this conclusion is made difficult by the failure of the district court to specify precisely how large that group is or to detail the bases on which it concluded that this group is insignificant.

Examining the record we find only the following bases for such a conclusion: two multivariate analyses of risk characteristics of bank and finance company customers, a comparison of several bank and finance company credit scoring systems, opinion testimony by bankers and finance company officials concerning credit practices, and figures showing the number of finance company customers with various types of bank credit. We will examine each of these bases in turn.

First, the defendants introduced at trial two multivariate analyses of the risk characteristics of a sample of individuals who were borrowers at either banks or consumer finance companies. In these analyses the authors examined several hypothesized variables of risk and attempted to determine if those variables were correlated with whether the individuals in the sample borrowed from a bank or a finance company. Based on that analysis, a model was derived which would predict whether a given

7. The defendants in their brief to this court characterize this conclusion as a "finding of fact" and argue that the district court may be reversed only if we find this conclusion to be clearly erroneous. We think, however, that whether the group of customers uniquely served by finance companies is significant enough to constitute a line of commerce within § 7 is a legal question. Certainly, the Supreme Court treated this as a legal question in *Connecticut National Bank* when it concluded simply that "the District Court overestimated the degree of competitive overlap . . . ." 418 U.S. at 656.

borrower, depending on his risk characteristics, was a borrower from a bank or a consumer finance company. That model was then applied to the sample from which it was derived to determine how well it would classify the sample members. In both studies, the authors noted some difficulty with the ability of such an equation to accurately classify members as bank or finance company borrowers. Neil Murphy, author of one of the studies, merely testified that the equation was "not able to classify the borrowers into categories terribly well." Tr. 1508. Gregory Boczar testified that when his model equation predicted that a sample member was a bank debtor, it would be right nine out of ten times. However, when his equation predicted that a sample member would be a finance company debtor it would be right only one out of three times. (Tr. at 1126-28). Both authors therefore concluded that there was no risk segmentation by banks and finance companies.

We do not believe that these studies support the proposition that there is not a significant class of consumers whose only alternative in the credit market is a consumer finance company. Certainly, the Boczar study demonstrates that a large number of consumer finance customers, specifically two-thirds, have risk characteristics which appear to make them theoretically eligible for bank loans. However, such a conclusion necessarily entails the related conclusion that one-third of those customers have characteristics which suggest that they would probably not be bank customers. Thus, this study does not negate the existence of a group of consumers whose credit needs are exclusively met by finance companies.

Indeed, we do not understand Mr. Boczar's conclusion that no market segmentation exists to negate the existence of this group given his definition of market segmentation. In his study, Mr. Boczar states that market segmentation hypothesis as follows: "[b]anks supposedly serve low-risk

borrowers while finance companies cover the highrisk borrowers." Thus after having found that finance companies contain a substantial number of low-risk borrowers in their customer base, Boczar appropriately rejected the market segmentation hypothesis. Boczar admitted that his rejection of the market segmentation hypothesis was largely premised on the mutual accommodation of low-risk customers by both banks and finance companies: "The results showed that there was substantial overlap in borrower characteristics between the two industries, largely due to the fact that finance companies served borrowers whose risk-related characteristics . . . were similar to . . . [those] of bank borrowers." (HX 2300). Thus, Boczar's rejection of market segmentation does not entail a conclusion that certain higher-risk customers remain exclusively tied to finance companies.

The Murphy study also does not support the position that there is no group of borrowers uniquely served by finance companies. The sample involved in this study was a group of borrowers in Maine that had previously been accepted for loans by finance companies, but because of changes in Maine law were not given loans by these companies. Murphy's study then sought to determine whether postulated risk characteristics would predict whether these borrowers would ultimately be accommodated by another lending institution. The analysis proved that there was a statistically significant difference in the risk profiles between those customers able to receive loans and those that were not. This, of course, means that for statistical purposes the groups were not completely identical. Murphy, however, concluded that there was an extreme overlap between the group because he was only able to predict unsuccessful borrowers 64 percent of the time and successful borrowers 52 percent of the time. Nonetheless, these figures demonstrate that for unsuccessful borrowers almost two out of three had risk characteristics that predicted they would be

unable to get a loan. Admittedly, these risk characteristics are less helpful in determining which borrowers will be successful, but this only means that financial institutions will not necessarily accommodate customers simply because they are low-risk. It is, for the purpose of our market analysis, only important that the study shows that previous finance company customers possessed risk characteristics making it unlikely that they would receive a loan from an institution.[8]

The second possible basis for the district court's conclusion was a study comparing credit-scoring systems. The defendants introduced a study in which recent applicants for loans from Household Finance were evaluated under the credit scoring system of the Security Pacific Bank and the VISA division of the First National Bank of Chicago. That study showed that 56 percent of the accepted HFC applicants would have satisfied the credit scoring requirements of Security Pacific and 35 percent would have satisfied the requirements of VISA. Of the declined applicants, 49 percent would have been acceptable to Security Pacific, whereas 28 percent would have been acceptable to VISA. (Tr. 1789-91). This study, however, runs directly contrary to the defendant's position: 65 percent of those able to obtain loans at Household Finance apparently would be unable to receive a VISA card from the First National

8. Both of these studies also appear seriously flawed in another respect. Obviously it is important that all major risk characteristics be utilized in the model, otherwise the predictive value of the model will be diminished and the degree of overlap between finance company and bank customers will be exaggerated. Boczar admits this in his study (HX 200 at 246), and Murphy conceded as much in his testimony at trial. (Tr. at 1547). Both studies left out a number of important risk variables. Neither included the borrower's total outstanding indebtedness, a factor which Boczar indicated would have been helpful. (HX 200 at 249 n.8). Additionally, the Murphy study excluded the following risk variables: time on job, time in community home ownership, rent and mortgage payments. The evidence in this case clearly demonstrated that all these factors were frequently used in credit scoring models used by financial institutions themselves to measure risk.

Bank of Chicago, and slightly under one-half would have been able to obtain loans from Security Pacific. Even though this study shows some overlap between credit standards, it nevertheless also shows a significant number of customers who would be served only by finance companies.

The third basis for the district court's conclusion was opinion testimony that banks and finance companies apply the same credit standards. Two bank officials from Pennsylvania banks testified that they believed that their banks applied the same credit standards as finance companies, although neither, of course, could testify as to how many other banks utilized similarly liberal standards. Indeed there was testimony from an executive vice-president of the First National Bank of Chicago that his bank's cash loan program was principally directed at executives and professionals (Tr. 1402) and that his bank had recently tightened its credit card operations to include only those eligible for $1,000 credit limits, thereby excluding people previously eligible for credit. (Tr. 1374, 1390). The defendants also introduced testimony from the chief executive officer of Beneficial Finance Company that his company was applying similar standards as other financial institutions, but even he was forced on cross-examination to admit that some customers are relegated to finance companies as their only source of loans. (Tr. 1305).

Finally, the court also attempted to support its conclusion that there was no risk segmentation among financial institutions by finding that a significant percentage of finance company customers are eligible for or actually have non-mortgage loans at banks and that a majority of the customers of consumer finance companies have bank credit cards. Even accepting these findings on their face, they have little bearing on whether risk segmentation exists. Even if a "significant" percentage are eligible for bank loans, the remainder--conceivably also a "sigificant" percentage--are not. Similarly by the terms of these findings

up to 50 percent of consumer finance company customers do not possess any bank credit cards.

Notwithstanding that these findings are not relevant to whether these are indeed high-risk customers served only by finance companies, we cannot find support for these statements in the record. The defendants introduced a study of recent HFC applicants in a Chicago loop office which showed that of 50 accepted applications, only 36 percent had outstanding bank loans of any kind, only 14 percent had loans from credit unions and that none had any loans from savings and loan associations. A similar study by the defendants on a nationwide sample of 426 customers showed that more than 75 percent of accepted HFC customers did not have bank credit other than auto loans and that approximately 70 percent did not have even auto loans. Likewise, only about 25 percent of the accepted customers had loans from credit unions and less than 3 percent had loans from savings and loan associations. (HX 209; Defendant's App. at 186). The chief executive officer of Beneficial Finance, another defense witness, testified that only 27.2 percent of Beneficial customers had loans from a bank and 16.4 percent had loans from credit unions. (Tr. 1317). The final evidence on this matter was the testimony by an officer of the target company in this case, American Investment Company, that 50 percent of American's customers had bank credit and that at least 15 percent of those without such credit would not even obtain that credit under any circumstances. (Tr. 1620-21). These figures do not support the district court's finding that finance companies do not lend to a significant percentage ineligible to borrow from other types of institutions, since even accepting the American executive's admitted speculation that at least 15 percent of those without bank loans could not obtain them, this still concedes the existence of a cognizable number of borrowers relegated to consumer finance companies.

The district court's finding that a majority of consumer finance customers had bank cards is even more difficult to support. There was evidence that 80 percent of the customers at one office had bank cards; [9] however nationwide HFC figures showed that only 32 percent of Household's customers had bank cards. (HX 209). Likewise, only 32 percent of Beneficial Finance customers have bank cards. (Tr. 1318).

Not only was the evidence of non-segmentation inadequate, but also the record contained overwhelming evidence that risk segmentation does in fact exist among financial institutions.[10] This evidence took three forms: studies of eligibility of finance customers for bank loans, varying charge-off and delinquency rates between banks and finance companies, and studies of the demographics of borrowers at both institutions.

We turn first to the four eligibility studies that were introduced. Dr. William Whitesell, an economics professor and former Federal Reserve Board economist, testified that he had done a study for a commercial bank seeking to acquire a finance company and found that 60 percent of

9. This was the figure given at trial. Our examination, however, of the exhibit on which this testimony was based reveals that this figure was erroneous. HX 210 showed that only 27 of 50 accepted Household customers, or 54 percent, had bank cards. Further, the office surveyed was located in the Chicago loop with a customer base of office and retail employees, a group that is not likely to be representative of HFC's entire customer base. (Tr. 1419).

10. The rest of our analysis concerns only whether finance companies serve a consumer base which is not served by commercial banks. We have limited this analysis because the record clearly demonstrates that banks are the only substantial alternate source of credit for finance company borrowers. Bank credit cards, as we have found, are not a significant alternative since almost two-thirds of all finance company borrowers do not possess such cards. Likewise, credit unions are not a significant alternative since the district court found, and we accept its finding, that one-half of all consumers do not have access to such an institution. Finally, savings and loan associations are generally restricted by state law principally to loans relating to, and secured by, real estate. The record below illustrated that only a minute percentage of finance company loans fell within this category.

the finance company customers would not have qualified for a loan at the bank considering the acquisition. (Tr. 115). An executive vice-president of CitiCorp testified that his examination of the files of 175 customers of Nationwide Finance Company, a subsidiary of CitiCorp, revealed that only 46 percent of them would be eligible for a loan from CitiBank, another subsidiary of CitiCorp. A study of Texas finance company borrowers, made by two economics professors revealed that, among the borrowers of small amounts, 25 percent had been refused loans by banks and 20 percent had been asked for too much collateral. (Tr. 486). Among the remaining borrowers, 30 percent replied that they had been refused by banks or that the banks required too much collateral.[11] The government also introduced a follow-up study on borrowers in Maine that had been accepted by finance companies for loans but later refused these loans because of a subsequent change in Maine law. Of those borrowers, 50 percent never received a loan from any source and only one-third of those who received loans (or about 16 percent of the entire sample) received a loan from a bank. Finally, it should be recalled that even the two defense studies, which we discussed earlier, lend some support to the conclusion that at least one-third of finance company customers have risk characteristics which suggest that they would be ineligible for bank loans. Thus, all these studies give a concrete demonstration of the existence of a significant class of borrowers, ranging from 20 to 50 percent of all finance company customers, who are able to obtain loans only from finance companies.

Evidence of delinquency and charge-off rates at banks and finance companies further supports a finding that finance companies offer services to a unique strata of

11. There was testimony at trial that customers who replied that the bank had required too much collateral had effectively been refused credit since that answer could have indicated that the bank had requested more collateral than the applicant could post. (Tr. 543). In any event, of this 30 percent, half were denied credit regardless of collateral. (*Id.*).

higher-risk customers that are not serviced by commercial banks. The testimony at trial was unequivocal and uncontradicted that finance companies charged off somewhere around 2 percent of their loans in terms of total dollars outstanding whereas banks charged off approximately 0.7 to 0.8 percent of their personal loans. (Tr. 1055). Several witnesses testified that this differential indicates that consumer finance companies serve some customers that are a higher risk than those served by banks.[12]

Finally, support for the existence of risk segmentation can be found in demographic studies conducted by the defendants. The defendants introduced evidence that showed that whereas the average income of those borrowers who exclusively used banks was $14,260, the average income for exclusive customers of finance companies was $9,050. Further, only 19.3 percent of consumer finance company customers were white collar, whereas white collar

12. Two defense witnesses gave different constructions to the differentials. An executive from Mellon Bank attributed the difference, at least as far as his own bank and its finance company subsidiary were concerned, to lack of experience among finance company officers in granting loans. This does not deny, however, that finance company borrowers, for whatever reason, may turn out to be a greater risk. Gregory Boczar, a defense expert, characterized the difference as follows:

> there was a difference, no question about it, and . . . this is very judgmental, but it was my view that the numbers were not so different as to suggest that commercial banks were only serving the very well to do and the finance companies were just taking the poor fellow who can't get a loan anywhere else. The issue, however, is not whether there is a total division between the types of customers of banks and finance companies but whether, notwithstanding any overlap in customer bases, finance companies service some customers unable to obtain bank credit. Mr. Boczar never denied that these figures certainly suggest the latter, less extreme position. Indeed, in one of the articles on which his testimony was based he concludes that "finance companies appear willing to service poorer risk borrowers than banks." (HX 212). Finally, defense testimony suggested that the charge-off rates exhibit a converging trend. But even that testimony revealed that finance company charge-off rates had declined only to slightly below 2 percent.

workers comprised 37.3 percent of bank borrowers. Conversely, only 17.5 percent of bank borrowers were blue collar, as opposed to 28.7 percent of consumer finance borrowers. (Tr. 832-33).

In summary, we conclude that the record below supports the proposition that finance companies offer unique products and services to a class of higher-risk customers than are serviced by other financial institutions. All the evidence suggested that these customers constituted anywhere from 15 to 50 percent of the finance company clientele. The district court never disputed these figures or suggested that they were lower. Indeed, even if these customers constituted a far lesser percent of the finance company clientele, we would still find that group significant. Thus, the finding of the district court that finance companies do not have a significant unique clientele was erroneous, and accordingly, the judgment below must be reversed.

REVERSED

A true Copy:
Teste:

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Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX C

UNITED STATES COURT OF APPEALS

For the Seventh Circuit
Chicago, Illinois 60604

September 13, 1979

BEFORE

Hon. LUTHER M. SWYGERT, *Circuit Judge*
Hon. WALTER P. GEWIN, *Senior Circuit Judge**
Hon. ROBERT A. SPRECHER, *Circuit Judge*

UNITED STATES OF AMERICA *Plaintiff-Appellant* No. 79-1313 *vs.*	Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
HOUSEHOLD FINANCE CORPORATION, HFC AMERICAN, INC., AND AMERICAN INVESTMENT COMPANY *Defendants-Appellees.*	No. 79 C 80 Frank J. McGarr, *Judge*

ORDER

On consideration of the petition for rehearing by the Court in the above-entitled matter filed by defendants-appellees, and no member of the panel and no judge in regular active service having requested that a vote be taken on the suggestion for an *en banc* rehearing, and the panel having voted to deny a rehearing,

IT IS ORDERED that, the petition for rehearing in the above-entitled cause be, and the same is hereby, DENIED.

Judge Philip W. Tone did not participate in the consideration of the petition for rehearing *en banc*.

* Walter P. Gewin, Senior Circuit Judge of the United States Court of Appeals for the Fifth Circuit, is sitting by designation.

Certificate of Service

I, HAVEN C. ROOSEVELT, hereby certify that I have today served three true and exact copies of the Petition for a Writ of Certiorari upon all counsel of record.

/s/ HAVEN C. ROOSEVELT

Haven C. Roosevelt

Sworn to before me this
1st day of November, 1979

/s/ BETTY YOUNG

Notary Public

BETTY YOUNG
Notary Public, State of New York
No. 31-4604067
Qualified in New York County
Commission Expires March 30, 1981

[Seal]